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RUEHDR/AMEMBASSY DAR ES SALAAM 6695  
RUEHBY/AMEMBASSY CANBERRA 0106  
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UNCLAS SECTION 01 OF 02 LILONGWE 000164

SIPDIS

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SUBJECT: MALAWI SIGNS URANIUM MINING AGREEMENT

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¶1. (U) Summary: The Government of Malawi has signed an agreement with Australian mining firm Paladin Resources to develop a uranium mine at Kayelekera, in the far northern region of the country. The agreement envisions a 10-year project that will produce approximately 1,000 metric tons of yellowcake uranium (U3O8) per year, with an annual value of nearly \$200 million at current market prices. The project provides a major boost to Malawi's struggling economy, and is an important test case to demonstrate the government's openness to foreign investment. End summary.

Breaking New Ground  
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¶2. (U) Malawi's mining sector is largely undeveloped, and this project with Perth-based Paladin Resources Ltd is the first large-scale mining project in the country's history. Until now, mining activity has been limited to a small coal mine, small-scale mining of mineral sands, and artisanal extraction of gemstones. Malawi has never conducted a formal geological survey, and the country's mineral resources are largely unknown. The limited information available on mineral resources comes mainly from surveys conducted during the British colonial period. Given the significant proven mineral resources in surrounding countries, it seems logical that mining should have great potential in Malawi.

¶3. (U) The uranium deposits at Kayelekera have been known for over 20 years, and were first explored by the UK Central Electricity Generating Board in the early 1980s. At that time, low market prices kept the discovery from being exploited. Paladin obtained a prospecting license in 1998, and commenced feasibility studies in ¶2000. With the recent increases in uranium prices on the world market, production is now economically feasible, and should prove to be a healthy investment, as long as uranium prices maintain the average \$60/pound that the company projects for the life of the mine. The current world price is about \$85/pound, and most experts predict it will go to \$100 by the end of 2007 and maintain that price over the near term.

¶4. (U) Paladin's investment in the Kayelekera project will total up to \$185 million. This will be the company's second major project in Africa; it also owns the Langer Heinrich uranium mine in western central Namibia, a project of similar size that commenced production in late 2006.

15. (SBU) The development agreement between the GOM and Paladin signed on February 22 was the fruit of nearly two years of protracted and difficult negotiations. When company managers began formal discussions in early 2005, they had originally hoped to have the agreement ratified by an act of parliament. In the poisonous atmosphere of Malawi's politics which prevailed at that time, however, the legislature was deadlocked and the company realized that parliamentary approval would be impossible. They elected to pursue an agreement solely with the executive, fully aware of the increased political risk. Negotiations with the weak Mutharika government moved slowly, and leaders proceeded with great caution. At the same time a number of local NGOs launched a campaign to oppose the mine. Senior government leaders were not swayed by their pleas to cancel the project, and quietly assured diplomats and the business community that they intended to reach an agreement. By late 2006, Paladin was close to a deal that provided sizable tax revenue and royalties for the government. But in November the GOM suddenly changed direction and demanded an equity stake in the project. Three more months of intense negotiation finally yielded an agreement that gave the GOM the equity it desired, in exchange for lower tax revenue and royalty payments.

16. (U) According to company press releases, the deal gives the GOM a 15 percent equity participation, with 27.5 percent corporate tax and 1.5 percent royalty in the first three years, and 3 percent thereafter. The GOM has also exempted the project from import duties and 17.5 percent VAT. The revenue from Kayelekera will increase Malawi's GDP by over 5 percent, and will account for 20 percent of total exports. Paladin has also pledged to fund a number of social development projects such as schools and clinics in the vicinity of the mine. The company has applied for a mining license, which they expect will be granted within 90 days. Construction of the mine and processing plant is expected to take about 18 months,

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and Paladin hopes to begin production in late 2008.

17. (SBU) Significant potential difficulties still lie ahead, however, if the experience of other foreign investors holds true. The Malawi Revenue Authority is notoriously aggressive, and promised tax breaks are often given only reluctantly. Other foreign firms that supposedly enjoy tax-free import of capital equipment and raw materials have found that MRA forces them to pay import duty up front and wait for long periods (sometimes up to a year) before refunding the tax. Other companies have faced great difficulty in securing temporary work permits for expatriate employees. Firms can wait months for approval of permits, and expatriate workers are sometimes forced to leave the country on short notice. The government has stepped up its empowerment campaign for "indigenous" Malawians, and a certain level of anti-foreign sentiment is palpable at the moment. Paladin plans to bring in a large number of foreign experts, particularly during the mine's construction phase, and may face significant hurdles with Malawian immigration authorities.

#### Important Test Case -----

18. (SBU) The U.S. Mission, the World Bank and other observers who track local economic development issues have followed the Paladin case with great interest, because it is the first major foreign investment in Malawi in many years, and is a pioneering foray into an undeveloped sector of the economy. Malawi's long history of state control has created an atmosphere that is almost hostile to private investment, and doing business here is not for the faint of heart. Poor infrastructure, low-skilled workers, endless red tape, predatory tax authorities and a general mistrust of private enterprise all conspire to create a business environment that is among the most difficult in Africa. But there is money to be made for those who are willing to take on the challenges, and many people are watching to see if Paladin succeeds. A second Australian firm, Globe Uranium, recently secured prospecting rights to a site in central Malawi, and has opened an office in Lilongwe. The government has declared mining to be a priority sector for its

economic development program, and says it wishes to encourage greater investment in mineral exploitation. If ore prices remain high and government plays a constructive role and uses its revenues wisely, uranium could well prove to be a big winner for everyone in Malawi.

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